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Discussion Points for a USA ©

A unanimous shareholder agreement (“USA”) restricts wholly or partially the powers of the Directors to manage the business and affairs of the corporation. The Shareholders assume the responsibilities and the liabilities of the Directors to the extent that they have restrained or removed rights, powers or duties from the Directors.

Where a USA is in effect, the Board of Directors should only be operative to do those things that only Directors can do under corporate law – such as declaring dividends, approving financials, appointing officers, etc. – that is, mainly routine, annual business or fundamental business that must be approved by Directors under specific corporate provisions. Care must be taken to ensure that the Board cannot act inconsistently with the USA. Thus, under a USA, I like to see the Shareholders first approve (or not) a matter, and then the Board can confirm its approval upon the direction of the Shareholders.

One way to ensure this synchronization is to make every owner a Director as well, but even then, it must be remembered that each Director gets one vote at the Board, whereas at the Shareholders’ table, the Shareholders vote their shares proportionately. My drafting and operational preference is to specify that the Board’s purview will be limited and must always be consistent with the will of the Shareholders.

Here are some of the main issues to consider for a USA:

1. **Is the agreement to be unanimous?** A USA can restrict the powers of the Directors to manage the affairs of the corporation, whereas a shareholder agreement that is not unanimous can only affect the rights and powers of the Shareholders who/which are party thereto. If the USA does restrict the powers of the Directors, it is the Shareholders who are liable for all the actions that they may take in place of the Directors. Note that Shareholders can be corporations, thereby affording some liability protection, as well as estate planning.
2. **Are there to be restrictions on the transfer of shares, for example, that no Shareholder shall transfer her/his shares without the transferee being bound by the agreement?** This clause prevents the agreement from being rendered inoperative by shares being transferred to a new Shareholder who is not a party to the agreement or bound by its terms.
3. **Is there to be a right of first refusal for existing Shareholders for shares offered for sale by a Shareholder?** A right of first refusal gives the existing Shareholders the first opportunity to purchase the shares of a Shareholder wishing to sell. Consider if the remaining Shareholders would want a stranger to become their Shareholder-colleague – not likely! This right is frequently coupled with a clause providing that existing Shareholders are entitled to purchase shares in the same proportion as their current

respective shareholdings to prevent a change in the balance of Shareholder's power. The latter clause would not be necessary in the case of two Shareholders.

What about takeover offers to one or some, but not other Shareholders? (drag-along and tag along provisions?)

Will there be a shotgun buy-sell provision? (I like shotgun clauses; they work!)

4. **Is there to be a provision for a mandatory transfer of shares in the event that a Shareholder ceases to be an employee, or becomes incapacitated, deceased or in serious breach of the agreement?** A mandatory transfer might require, for example, that a Shareholder who is also an employee and who refuses or becomes incapable of performing his duties as employee be obliged to sell her/his shares to the other Shareholders.
5. **What is the mechanism, if any, for valuing shares of the corporation for the purpose of a purchase under a right of refusal or mandatory transfer?** A value may be set based on some objective standard in the corporation's financial position, as reflected by its financial statements, or may be arbitrarily agreed upon by the parties. It's a good idea to value shares annually in any event.
6. **Will the election or duties of the Directors or officers be restricted wholly or partially?** A USA can provide that one or more of the Shareholders perform acts otherwise performed by the Directors of the corporation. It may provide that the Shareholders exercise their voting rights so as to keep a specified Director or Officer in office while the USA is in effect. As noted above, I favour restricting the role of the Board, and not getting into complex nominee, meeting and voting procedures at the Board level – simply let the Shareholders vote their shares on major matters.
7. **Will there be a provision on how shares are to be voted, such as a voting trust or pooling arrangement?**
8. **Is the quorum for Shareholder & Director meetings as specified in the by-laws to be altered?** I recommend a high quorum for both Shareholder and Director meetings.
9. **Is there to be a provision for the corporation to obtain life insurance policies on the lives of its Shareholders?** This is a standard clause in agreements pertaining to corporations having a small number of shareholders.
10. **Is there to be a provision for the corporation or other Shareholders purchasing the shares of a deceased shareholder?** A standard provision requiring tax advice from the accountant.

11. **How are disputes over the provisions of the agreement to be resolved? i.e. arbitration?** Such a clause may provide that disputes arising from the agreement be settled by a named arbitrator or one appointed in accordance with a set mechanism of appointment. Arbitration may be more desirable than recourse to the courts. The

arbitrator's decision can be made a pre-condition to access to the courts, i.e., in which case no legal action shall have commenced before the matter has gone to arbitration and the arbitrator's decision found unsatisfactory. However, only major disputes should go to arbitration, as it's expensive and slow, too.

12. **Are all Shareholders active employees and officers?**

What happens if a Shareholder/employee is terminated or quits? (forced sale of shares? severance?) In most cases, it will be best if terminated employees relinquish shares at a fixed price or according to a formula.

How can a Shareholder/employee be fired or demoted? This is always a touchy issue.

13. **What are job duties of each employee/Shareholder?**

How is compensation to be decided? (fixed or annual review?) Salary ≠ ownership share.

How are bonuses to be allocated? (as per shareholdings or on merit?)

Will Shareholders be required to loan back after tax portion of bonuses?

A static compensation system can breed resentment or worse. Never fix the operating Shareholder's compensation if there is an inactive Shareholder or two. Consider rotating responsibilities if there is equality of skills/experience in Shareholders.

14. **Are there any non-arms' length deals or employments to be allowed? (spouse, child of shareholder)** I recommend a prohibition unless high level consent of other Shareholders.

How is their compensation to be determined and adjusted?

What happens if that Shareholder party leaves?

15. **Signing authorities: Who can sign cheques? Major contracts? Make commitments?** This is normally spelled out in detail, unless the Shareholders carry out quite separate and non-overlapping duties – one does sales, other does service and admin, etc. What is the practical, daily decision process? No one holds shareholder meetings daily or weekly, but decisions must be made.

16. **Liability exposure, guarantees: Who will be required to guarantee debts of the corporation?**
Who will mortgage their house or other assets to inject cash?
Is that Shareholder to be rewarded for doing so, or others penalized for not doing so?
17. **What is the succession plan?** Are there estate plans or wills to be done? Marriage/Pre-Nuptial Agreements?
18. **Will a holding body corporate be used?** This is usually recommended to shield liability against intellectual property, retained earnings, assets and cash in the operating corporation vis-à-vis third parties - creditors, suppliers, negligence actions.
19. **What is to be the mechanism for amending the USA?** This should be expressed as a very high percentage approval - perhaps unanimous - because any amendment can greatly alter the business deal. No meeting of Directors or Shareholders should be allowed to effect an amendment unless the requisite majority is met and the amendment is expressly designated as an amendment to the USA.
20. Are there any other special conditions or provisions desired to be included?
21. Are there any major items to be completed before or with the completion of the USA? (adding more Shareholders, documenting shareholder loans, changing share capital, amending Articles, s. 85 rollovers to a holdco, paying for shares).

The above represent some of the more salient concerns typically addressed by a unanimous shareholder agreement. I would be pleased to expand further on any of the above matters should you so desire. We can't possibly address every eventuality, so the best we can do is to cover the major issues in a manner that has been successfully used (interpreted, implemented and enforced in the Courts) in the past (avoid novel mechanisms that the parties, lawyers and the Courts won't understand).

I look forward to receiving your comments on the above.

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